546-D GA 1.13: HRD-81-117/sum.

BY THE COMPTROLLER GENERAL

COMPLETE 10

Report To The Congress

OF THE UNITED STATES

ORIGINAL

Tax Revenues Lost And Beneficiaries Inadequately Protected When Private Pension Plans Terminate

SUMMARY

Many terminating private pension plans are not voluntarily requesting the Internal Revenue Service (IRS) reviews for protecting participants' rights to benefits, and termination actions are not being reported to the Pension Benefit Guaranty Corporation--the agency responsible for insuring payments. Also, IRS processes for collecting taxes due on pension asset disbursements are incomplete and millions in tax revenues have been lost. The Corporation and IRS have initiated actions to correct some of these problems, but more needs to be done.

The Congress should amend the Internal Revenue Code to require sponsors of terminating pension plans to obtain an IRS review of participant protection requirements before plan dissolution. IRS should improve reviews of pension plan terminations and disbursements, and the Corporation, in cooperation with IRS, should establish procedures for timely identification and follow-up actions on unreported plan terminations.

HRD-81-117

SEPTEMBER 30, 1981

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COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

TAX REVENUES LOST AND BENEFICIARIES INADEQUATELY PROTECTED WHEN PRIVATE PENSION PLANS TERMINATE

D I G E S T

The Internal Revenue Service (IRS) and the Pension Benefit Guaranty Corporation have not been effective in helping ensure that participants obtain entitled benefits when private pension plans terminate. The Chairman of the Subcommittee on Oversight, House Committee on Ways and Means asked GAO to review the effectiveness of these agencies' efforts to protect participants in private pension plans and to insure proper disclosure of plan asset disbursements for tax purposes.

GAO's analysis for 1977 showed that, for about two-thirds of reported terminations, plan sponsors were not requesting IRS reviews at the time of termination because they are not mandatory under the Internal Revenue Code. Termination actions were not being reported to the Corporation, which is responsible for insuring participants' benefits. Thus, at the time of termination there is no assurance that, for many such plans, the participants are adequately protected as required by the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code.

Further, IRS reviews of terminating pension plans requested by plan sponsors have not been effective in protecting participants' benefits, and IRS processes for collecting taxes due on plan asset disbursements are incomplete. Substantial tax revenues--$9.6 million for tax year 1976 alone--have been lost because IRS had not fully compared employer and employee tax reporting information on asset disbursements to individuals. The Corporation and IRS have begun actions to correct some of these problems, but more needs to be done.

IRS SHOULD MAKE MORE COMPLETE REVIEWS OF PENSION PLAN TERMINATIONS

IRS reviews of private pension plan termination actions have not assured that terminating plans conform to ERISA and the Internal Revenue Code requirements, which are designed to protect participants' benefits. Guidelines for IRS reviews

have been fragmented and often they are unclear on the purpose or objective to be sought by IRS reviewing officials. As a result, terminating plans have been reviewed and favorable determinations of conformance rendered by IRS without:

--Information necessary to determine whether plans are qualified.

--The plans having met requirements established under ERISA and the Internal Revenue Code to protect participant benefits.

--Resolving reported discrepancies or questionable plan operations. (See pp. 7 to 18.)

IRS reviews had been completed without adequately addressing (1) inconsistent termination dates reported by pension plan administrators, (2) potentially incorrect asset distributions, (3) discrepancies in reported plan assets or eligible plan participants, and (4) possible loss of benefits by participants after many years of service because of termination of employment. Without further pursuit of these issues, through inquiries with plan administrators and participants and requests for substantiating documentation, IRS did not assure that plan participants were treated equitably.

GAO discussed these problems with IRS headquarters officials. Subsequently, IRS developed (1) an agency training course covering termination reviews and (2) new procedures for IRS reviewers to use in identifying plan problems and issues to be pursued. These developments should help to alleviate many of the processing weaknesses GAO identified; however, additional criteria for guiding IRS review efforts are needed. (See pp. 17 and 18.)

BETTER GOVERNMENT PROCEDURES NEEDED TO IDENTIFY UNREPORTED PLAN TERMINATIONS FOR REVIEW

IRS improvement of reviews of terminating private pension plans will not, of itself, assure that the participants of terminating plans are adequately protected. IRS reviews before termination are not mandatory, and thousands of sponsors have elected not to subject their plans to an IRS review at termination or have waited long time periods, even

years, after terminating their plans before requesting an IRS review. Delays or inaction reduce the opportunity for identification and correction of plan problems to help assure participants' benefits are protected. Timing is critical to assure Government and participant involvement in decisions on the distribution of assets.

At termination, plan sponsors may self-determine whether their pension plan actions conform to participant protection requirements of ERISA and the Internal Revenue Code or they may request IRS to determine whether their actions conform. For plans that conform, plan sponsors and their participants are eligible for preferential tax treatment.

IRS has been concerned that plans which have not voluntarily requested its review--at some point during the plan's operation life or at termination--are more likely not to meet ERISA and Internal Revenue Code requirements. IRS has examined and plans to continue examinations (audits) of plans that do not request IRS reviews in an effort to mitigate potential problems with unreported plan noncompliance. However, the length of time required for IRS to identify the occurrence of a plan termination means that these examinations ordinarily cannot be made until several years after the plans terminate. This does not provide plan participants with the advantages and benefit protection that an IRS review before termination would provide. Timely recognition and review of terminations by IRS can provide greater assurance that:

--Plans meet ERISA and the Internal Revenue Code participant protection requirements and are tax qualified.

--Participant benefits will be guaranteed by the Corporation under ERISA's termination insurance programs.

--Plan participants have a vehicle to protect their own interests through direct involvement in the sponsors termination actions.

--Less future Government effort will be spent in making detailed examinations of plans years after termination. (See pp. 21 to 25.)

Thousands of pension plans terminated since the enactment of ERISA without requesting an IRS review or in some cases without notifying the Corporation. The Corporation and IRS initiatives directed at obtaining more accurate and timely data on plan terminations have met with limited success because of difficulties in developing reliable computer data on plans that have terminated and reluctance to use faulty data to contact pension plans to determine their status. These difficulties have militated against the effective use of staff and available resources, and a more coordinated effort using Federal automated records is needed. Requiring pension plans to obtain an IRS review before plan dissolution as a basis for tax qualification should better protect participants' benefits and improve reporting of plan terminations. (See pp. 25 to 27.)

IMPROVED OVERSIGHT OF PENSION ASSET DISBURSEMENTS COULD INCREASE TAX REVENUE

Many employees or their beneficiaries receive one-time lump-sum distributions of plan assets (called pension payouts) before their retirement years when pension plans are terminated, employees terminate employment, or employees die or become disabled. During tax year 1976, the most recent year for which total IRS data were available, about 2 million individuals discontinued participation in pension plans and received an estimated $6 billion in pension payouts. IRS procedures for identifying and processing tax compliance information on recipients of these payments have not been adequate. Pension payouts are taxable when received as ordinary income or capital gains unless the recipient elects to reinvest the sum received in another qualifying pension plan.

Although IRS made $4.3 million in tax assessments for unreported pension payouts in tax year 1976, IRS did not process most of the employer pension payment documents it received, and it had not developed a method for assuring that employers are filing required forms. If pension payouts are not processed by IRS for the year received there is little likelihood the one-time payments will ever be reviewed. The full loss from not processing pension payouts could not be determined from IRS records. However, GAO found that (1)

$9.6 million in tax revenues were lost for tax year 1976 alone (2) IRS resources have been expended unnecessarily to manually screen thousands of individuals' income tax returns to reconcile apparent pension payout reporting discrepancies because IRS had not developed effective computer matching procedures. (See pp. 31 to 35.)

Before tax year 1980, IRS sampled about one-third of the pension payouts reported by employers as ordinary income above certain dollar tolerance levels for comparison with individual income tax returns. Unprocessed forms have been destroyed through tax year 1979. GAO discussed with IRS the potential for additional tax recovery through full processing of pension paycuts. As a result, IRS initiated a program in 1981 providing for full matching of tax year 1980 pension payout filings reported by employers as ordinary income above certain dollar tolerances. GAO believes this is an important step and that additional tax recovery can be obtained by matching pension payout data reported by employers as capital gains. (See pp. 35 and 36.)

RECOMMENDATION TO THE CONGRESS

In support of ERISA and the Internal Revenue Code policies protecting the rights of pension plan participants to promised benefits, the Congress should enact legislation that would make pension plan determinations by IRS mandatory for tax qualification of terminating private pension plans before plan dissolution. (See p. 29.)

RECOMMENDATIONS TO THE EXECUTIVE DIRECTOR OF THE PENSION BENEFIT GUARANTY CORPORATION AND THE COMMISSIONER OF INTERNAL REVENUE

GAO recommends that the Executive Director, in cooperation with the Commissioner, use the automated records of both agencies to identify nonreporters of plan terminations and establish procedures for timely followup with the potential nonreporters to ensure participants in terminated plans, entitled to retirement benefit insurance, are afforded the protection intended by the Congress under ERISA. (See p. 29.) GAO makes several recommendations to the Commissioner of Internal Revenue to improve IRS reviews of pension plan

termination actions and the IRS processes for collecting taxes due for pension asset disbursements. (See pp. 18, 29, and 36.)

AGENCY COMMENTS

IRS and PBGC officials advised GAO that they agreed with the recommendations in this report. Comments they provided have been incorporated in appropriate sections of this report and are included in appendixes III and IV. (See pp. 18, 29, and 37.)

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ABBREVIATIONS

ERISA	Employee Retirement Income Security Act
GAO	General Accounting Office
IRS	Internal Revenue Service
PBGC	Pension Benefit Guaranty Corporation